No. 15,350

IN THE

# United States Court of Appeals

## For the Ninth Circuit

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William B. Cammarano and Louise Cammarano, his wife,

*Appellants,*

vs.

United States of America,

*Appellee.*

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## REPLY BRIEF OF APPELLANTS.

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Athearn, Chandler & Hoffman,
Walter Hoffman,
Clark W. Maser,
Seventh Floor, Balboa Building,
San Francisco 5, California,

Jones & Grey,
A. R. Kehoe,
Hargrave A. Garrison,
610 Colman Building, Seattle, Washington,
*Attorneys for Appellants.*

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| WILLIAM B. CAMMARANO and LOUISE CAMMARANO, his wife, *Appellants,* | |
| vs. | |
| UNITED STATES OF AMERICA, *Appellee.* | |

## REPLY BRIEF OF APPELLANTS.

In the same order in which Appellee has presented its contentions Appellants now reply.

### CLARIFICATION OF STATEMENT OF FACTS.

Preliminarily certain statements regarding the facts should be clarified.

The Washington Beer Wholesalers Association neither received nor paid out any funds expended in connection with the Initiative. All contributions were paid to a fund, separate and apart from the Association. Members and non-members of the Association

made contributions to the fund on the basis of the volume of business of each contributor. All disbursements in combatting the Initiative were made by an overall Industry Advisory Committee (TR. 77, 79, 84, 85, 86).

The fund was created for the specific purpose of combatting the Initiative voted upon by the People in November, 1948 and the fund was used solely for that purpose. The Washington State Legislature was not in session during 1948 (TR. 23, 45, 46).

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**(1) REPLY TO CONTENTION: "THE COURT DECISIONS WHICH HAVE CONSTRUED THESE PROVISIONS HAVE UNIFORMLY HELD THAT SUMS OF MONEY SPENT . . . FOR THE PROMOTION OR DEFEAT OF LEGISLATION . . . AND WHICH ARE SIMILAR TO THE PAYMENTS MADE IN THE PRESENT CASE DO NOT CONSTITUTE THE ORDINARY AND NECESSARY EXPENSES OF CARRYING ON A TRADE OR BUSINESS . . ." (Appellee's Br. 8, 9).**

The provisions referred to are the provisions of Section 23(a)(1)(A) and Treas. Reg. 111, Sec. 29.23(o)-1.

The following classification of all of the fifteen decisions cited by Appellee, shows that the expenditures involved in those decisions are not "similar to the payments made in the present case."

**(a) Decisions where the payments did not pertain to carrying on an existing business but on the contrary related to a future business.**

Expenditures incurred in: *McDonald v. Commissioner,* 323 U.S. 57, to be elected a Judge in the future;

*Revere Racing Assn. v. Scanlon,* 232 F. 2d 816 (C. A. 1st), to legalize dog racing for a future four year period; *Mays v. Bowers,* 201 F. 2d 401 (C. A. 4th), to be elected a City Councilman; *Davis v. Commissioner,* 26 T.C. 49, to legalize the sale of liquor for a future two year period; *Kyne v. Commissioner,* 35 B.T.A. 202, to legalize horse racing in the future; *Mosby Hotel Co. v. Commissioner,* 1954 P-H T.C. Memorandum Decisions, par. 54,288 (13 T.C.M. 996), to legalize the future sale of liquor and in addition for lobbying.

In contrast to the foregoing cases, taxpayers here were in an existing business with the right to continue in same indefinitely and were not dependent upon a vote of the electorate for the future commencement of their business or for the right to engage in business in the future after expiration of a fixed term. The expenditures were incurred in defending and carrying on an existing business and not a future business precisely in the same manner that the mail order dentist in *Commissioner v. Heininger,* 320 U.S. 467 incurred expenditures in defending his business—there an assault against his business by the Postmaster General—here an assault against taxpayers' business by the proponents of the Initiative.

**(b) Decisions involving public policy.**

In *Textile Mills Sec. Corp. v. Commissioner,* 314 U.S. 326, the expenditures were of a certain type for "lobbying" in "legislative halls" and so characterized by the Court in its opinion and in two subsequent Supreme Court decisions, *Commissioner v. Heininger,* supra,

and *Lilly v. Commissioner,* 343 U.S. 90; *American Hardware & Eq. Co. v. Commissioner,* 202 F. 2d 126 (C. A. 4th) and *Roberts Dairy Co. v. Commissioner,* 195 F. 2d 948 (C. A. 8th), involved expenditures incurred in connection with legislation pending in "legislative halls" (i.e.: Congress); *Bellingrath v. Commissioner,* 46 B.T.A. 89, involved expenditures in furtherance of "lobbying" before the legislature of Alabama; in *Cullen v. Commissioner,* 41 B.T.A. 1054, taxpayers paid a sum of money to a Committee to uphold taxpayers' right to file separate Federal income tax returns under the community property laws of Texas and another sum to oppose Federal legislation giving the Secretary of the Interior broader powers over all the oil industry in Texas. With respect to the first item, the Court held the expenditures were purely personal and not connected with any business. With respect to the second item the expenditures were incurred in connection with legislation pending in "legislative halls" (i.e.: Congress) and additionally the Court held the expenditures were "too remote"; in *McClintock-Trunkey Co. v. Commissioner,* 19 T.C. 297, taxpayer paid a total of $190.00 in dues to three associations: the Washington Beer Wholesalers Association, Taxpayers' League and Good Roads Association. The Good Roads Association and the Taxpayers' League were admittedly active in sponsoring legislation in the Washington legislature. The Washington Beer Wholesalers Association was active in opposing the Initiative. The amount of dues paid to each association was not specified and the

Court treated the $190.000 so paid *collectively as a single expenditure.* The Court held that a substantial part of the activities of the three organizations might *collectively* be regarded as lobbying and hence denied a deduction on the ground of the Regulation. Taxpayer under such circumstances simply failed to meet the burden of proof in showing what portion of the $190.00 so collectively expended was not for lobbying and in any event failed to affirmatively show that the expenditures were "ordinary and necessary". We are indeed surprised that Appellee has cited said decision because when reference was made to the decision in the lower Court, counsel for Appellee stated "we are not relying on this case" (TR. 125-124).

Inasmuch as the *Textile* case involved expenditures incurred in connection with legislation pending in "legislative halls", the lower courts in the above cases [except for the *Cullen* case which was decided in 1940], without considering further whether or not the *Textile* decision was limited to only certain types of lobbying in legislative halls, followed said decision.

In any event the instant expenditures were not in any way incurred in connection with legislation pending in "legislative halls" or for "lobbying" in "legislative halls".

Furthermore, Appellee in its brief admits that the application of the Regulation to the instant expenditures cannot be justified on grounds of public policy (Appellee's Br. 6, 18-23).

**(c) Decisions where the Regulation may be regarded as having been validly applied within the authorized rule-making authority of the Commissioner in interpreting "ordinary and necessary" and where the expenditures only indirectly or remotely affected taxpayer's business.**

In the *American Hardware* and *Roberts Dairy* decisions, supra, the expenditures were made to associations which in turn used the sums in the furtherance of the enactment of legislation placing heavier tax burdens upon competitive cooperatives. Inasmuch as the expenditures only remotely and indirectly affected taxpayers, the expenditures may be said to have been properly barred by the Regulation aside from considerations of public policy. In *Old Mission P. Cement Co. v. Commissioner,* 69 F. 2d 676 (C. A. 9th), the expenditures only remotely affected taxpayer's business and the Court properly found the expenditures not ordinary and necessary without referring to the Regulation. In *Sunset Scavenger Co. v. Commissioner,* 84 F. 2d 453 (C. A. 9th) the expenditures made in 1927 pertained to an ordinance providing for an additional method of issuing scavengers' licenses and the expenditures in 1929 pertained to a measure which was merely a declaration of policy regarding the municipal collection of garbage—any future definitive action was reserved to the Board of Supervisors. In both instances therefore the effect of the measures on taxpayer's business was conjectural and remote. The Court rested its final decision on the *Old Mission* case where no regulation was involved. In *Wm. T. Stover Co. v. Commissioner,* 27 T.C. No. 48, taxpayer, engaged in the sale of medical supplies, incurred expenditures in sending a reporter to Great Britain for

the purpose of publishing a report on socialized medicine favorable to the physician customers of taxpayer, who in turn were interested in legislation relating to socialized medicine. Thus the expenditures only very remotely affected taxpayer's business.

The expenditures in the foregoing cases only indirectly and remotely affected taxpayers' business and therefore may be regarded as falling within the field of a valid application of the Regulation and within the authorized rule-making authority of the Commissioner. In contrast, the instant expenditures were made to preserve the very life of taxpayers' business: had the Initiative been enacted taxpayers would have been deprived of all their existing customers. Taxpayers were wholesalers and their customers were retailers. The Initiative expressly provided that after its enactment all retailers were prohibited from selling beer.[1]

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[1]In *Morgan v. Tate & Lyle, Ltd.*, (1953) Ch. 601 (C.A.), (1953) 2 All E. R. 162, (1953) 1 W.L.R. 145, *aff'd* (1954) 2 All E.R. 413, (1955) A.C. 21 (House of Lords), involving a factual situation almost identical to the instant case and holding that expenditures by a sugar refining company in a publicity campaign against proposed nationalization of the British sugar refining industry were deductible from gross income as "disbursements or expenses . . . laid out or expended for the purposes of the trade . . .", the Court of Appeal said: "If my goods do not appeal to the public and my competitor's do, he and not I will earn the profits which are to be made by selling the class of article which I have to offer. I therefore institute an advertising campaign with the object of belauding my goods and dispraising his: my design is that customers shall resort to my shop and not to his when they require the article in question. *So here, the consumer is to be persuaded that he (or she) will get more or better or cheaper sugar by allowing the trade to be controlled by the respondents and their rivals than by entrusting it to the hands of the pundits in Whitehall.* It is conceded that the expense of a campaign of the former sort would be allowable; and rightly, for the money is laid out for the purposes of the trade. Equally so, in my judgment, is money spent on the latter object." (1953) 1 W.L.R. at pp. 155-156 (italics ours).

In contrast to the lower Court decisions so cited by Appellee, the Supreme Court in *Commissioner v. Heininger,* supra, has emphatically and clearly stated that expenditures incurred in the defense of and in the preservation of the continuance of an existing business are "ordinary and necessary" within the language of Section 23(a) beyond question. The *Heininger* holding was expressly reaffirmed in the subsequent *Lilly* case.

In *Bingham's Trust v. Commissioner,* 325 U.S. 365, the Supreme Court held that to the extent a regulation bars as a deduction expenditures which are ordinary and necessary, such application of the regulation is invalid.

Appellee has not replied to the three foregoing cases so cited by taxpayers—beyond the statement of a general conclusion that said cases "are not applicable". (Appellee's Br. 22.)

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**(2) REPLY TO CONTENTION: "AT THE OUTSET, TAXPAYERS QUESTION (Br. 11-22) WHETHER THIS PROHIBITION CONTAINED IN SECTION 29.23(o)-1 OF THE REGULATIONS IS APPLICABLE TO SECTION 23(a)(1)(A) OF THE STATUTE." (Appellee's Br. 9.)**

The foregoing statement is not correct. Taxpayers explicitly stated at page 21 of their brief: "In the topics considered in this brief relating to the rule-making authority of the Commissioner [but not with respect to the topic of statutory re-enactment] . . . the Regulation relating to individuals may be referred to Sec. 23(a)."

On the other hand in considering the question of statutory re-enactment it is obvious that the history, indexing, captioning and the Commissioner's interpretation of the Regulation are important factors because: the basis of statutory re-enactment in any event can rest only on the imputation that Congress in re-enacting Section 23(a) did so with the Regulation in mind.

In seeking to refute a position not taken by taxpayers, Appellee has set forth at great length the history of the Regulation relating to corporations with only glancing reference to the history, indexing and captioning of the Regulation pertaining to individuals. It is important to observe that the provision of the Regulation here in question was not inserted in the Regulation pertaining to individuals until 1939—twenty-one years after the insertion of said provision in the Regulation pertaining to corporations. It is not for taxpayers to suggest why the difference in the Regulations during all those years. It should be observed, however, that in connection with other subjects Congress saw fit to treat individuals differently from corporations: thus an individual even though engaged in business was permitted to deduct charitable contributions, whereas a corporation was not so permitted until 1935.

It should also be observed that aside from a compilation of the already existing internal revenue laws in the Internal Revenue Code of 1939 and the addition of sub-paragraph (a)(1)(C) in 1941 [1941 Excess Profits Tax Amendments, Sec. 10(b)], Section

23(a), at the time of the taxable events in the instant case, had only at the very most been re-enacted once from the time of the first insertion of the provision relating to "lobbying" in the Regulation pertaining to individuals: in 1942 paragraph numbered (1) was changed to (1)(A) and the heading "Trade or Business Expenses" was inserted. During all of this time the Regulation was: indexed and captioned under Section 23(o) an entirely different section of the Code in concept and purpose from Section 23(a). Section 23(o) was captioned and dealt with "Charitable and other contributions". The Regulation in its body repeatedly referred to Section 23(o). Buried in the midst of the voluminous provisions of the Regulation dealing solely with charitable contributions was the provision here in question purporting to deal with business expenses (for text of Regulation see Appellants' Brief, Appendix, page i). In the light of these circumstances it is entirely fictional and unreasonable to even remotely impute to Congress a knowledge of the provision.

It is significant that the Treasury, since the *Cammarano* case, in proposed Income Tax Regulations under the Revenue Code of 1954 is now indexing the Regulation under Section 162 (successor to Section 23(a)), rather than under Section 170 (the successor to Section 23(o)). [Appellee's Br. 13, f.n. 1.]

**(3) REPLY TO CONTENTION: "THE GENERAL PRINCIPLE THAT REPEATED CONGRESSIONAL REENACTMENT OF THE STATUTORY PROVISION TO WHICH A REGULATION PERTAINS, HERE SECTION 23(a)(1) (A) OF THE 1939 CODE, GIVES TO THE REGULATIONS THE FORCE OF LAW . . ." Appellee's Br. 14).**

In the three Supreme Court decisions cited by Appellee, application of the regulation did not directly contravene the provisions of the statute. The principle of statutory re-enactment has never been invoked where the application of a regulation with respect to particular facts directly contravenes a statute because where "the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation", *Koshland v. Helvering,* 298 U.S. 441, 447 (1936) (successive re-enactments of a statute after the issuance of a regulation). "Long-continued practice and approval of administrative authorities may be persuasive in the interpretation of doubtful provisions of a statute, *but cannot alter provisions that are clear and explicit when related to the facts disclosed", Louisville & N.R. Co. v. U.S.,* 282 U.S. 740, 759 (1931) (italics ours) (repeated re-enactments of a statute after issuance of a regulation). "The most familiar limitation upon the doctrine of re-enactment is the qualification that if the regulation definitely goes beyond the limits of the statute, no amount of legislative re-enactment will validate the ruling. *To hold otherwise would mean that taxpayers could never rely upon the clearest terminology of a statute". Studies in Federal Taxation, Third Series,* Randolph E. Paul, (p. 435) (italics ours).

Here the expenditures as stated by the Supreme Court in *Commissioner v. Heininger,* supra, are ordinary and necessary beyond question. To apply the Regulation to such expenditures would therefore directly contravene Section 23(a) and would be tantamount to an abrogation of the statute as applied to the instant expenditures. Clearly the doctrine of statutory re-enactment cannot be invoked to produce such a paradox: that the taxpayer should be remitted to a regulation to ascertain whether a particular application of a statute has been revoked—and here under circumstances where the provision of the Regulation was not even indexed or captioned under Section 23(a) and where the provision was buried in the midst of the voluminous regulation pertaining to charitable deductions.

Appellee cites *Sunset Scavenger Co. v. Commissioner,* supra. But that case also made express reference to the limitation that the doctrine of statutory re-enactment is not applicable where "the language of the act is unambiguous and the regulation clearly inconsistent with it" (page 457).

Appellee cites the *Textile* case. Statutory re-enactment was not discussed or mentioned in that decision. Furthermore the Court characterized the Regulation as a "ban" against "lobbying" in "legislative halls". Such characterization of the Regulation immediately raises the question: what scope or construction of the Regulation could possibly be imputed to Congress under any theory of statutory re-enactment?

It certainly would be paradoxical to impute to Congress a construction of the purported scope of the Regulation contrary to that of the Commissioner. Yet here the Commissioner, by his acquiescence in *Luther Ely Smith v. Commissioner,* 3 T. C. 696—promulgated after the decision in the *Textile* case and never withdrawn—has publicly and unequivocally declared that expenditures incurred in connection with measures voted upon by the People are deductible where they are found to be ordinary and necessary. Taxpayers, of course, are unable to state what reasons prompted the Commissioner to publicly announce said acquiescence other than the fact that expenditures incurred in connection with measures submitted to the People involve considerations of policy entirely different than those involved in "lobbying". It is pertinent to observe that the Commissioner's acquiescence conforms with: the initial construction which the Commissioner gave the Regulation pertaining to corporations which he initially captioned "Lobbying Expenses"[2], and also conforms with the construction which the Supreme Court placed on the Regulation pertaining to corporations in the *Textile* case. It is significant to note that the acquiescence

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[2]See Appellee's Br. 11, f.n. 1: "As pointed out, supra, both T.D. 2137, and Article 143 of Treasury Regulations 33 (1918 ed.), were an interpretation of the phrase 'ordinary and necessary', and both incorporated the prohibition under provisions labelled '*Lobbying Expenses*'." (italics ours) In *U.S. v. Rumely,* 345 U.S. 41 (1953), the Supreme Court held that the word "lobbying" does not embrace "attempts to saturate the thinking of the community" (p. 47).

of the Commissioner took place after the decision in the *Textile* case.

Thus the theory of statutory re-enactment cannot be invoked: first, because the instant application of the Regulation would directly contravene Section 23(a); secondly, because of the captioning, indexing and context of the Regulation; and, finally and conclusively, because the Commissioner himself has not construed the Regulation as applicable to the instant expenditures as evidenced by his acquiescence in the *Luther Ely Smith* decision, supra.

It is pertinent to note that the trend of recent Supreme Court cases accords only limited or no recognition to the theory of statutory re-enactment. Thus the Supreme Court has spoken of the theory as "at best only an auxiliary tool for use in interpreting ambiguous statutory provisions", *Jones v. Liberty Glass Company,* 332 U.S. 524, 534 (1947) and as "an unreliable indicium at best", *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 431 (1955).

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**(4) REPLY TO CONTENTION: "THE TWO SUPREME COURT DECISIONS MOST RELEVANT TO THE PRESENT PROCEEDINGS ARE TEXTILE MILLS CORP. v. COMMISSIONER, SUPRA, AND McDONALD v. COMMISSIONER, 323 U.S. 57." (Appellee's Br. 15.)**

The *Textile* decision will be discussed under the next topic.

*McDonald v. Commissioner* is clearly distinguishable. Section 23(a), aside from the requirement that

the expenditures must be "ordinary and necessary", provides that the expenditures must be incurred "in carrying on any trade or business". Implicit in the latter requirement is a present relationship of the expenditures to an existing business—not a future business. Thus where a Judge seeks to be newly elected to office, the expenditures clearly are referable to a future business and not an existing business; also where a Judge seeks to be re-elected his expenditures are likewise referable to a future business because his present office is only for an expirable term and the expenditures therefore have no relation to the present term of his business.

In contrast to the expenditures in the *McDonald* case and in similar cases cited, the instant expenditures pertained to a presently existing business, the very existence of which would have been destroyed had the Initiative passed because: the business would have been deprived of all of its existing customers. The expenditures so incurred in defending and preserving an existing business are the same as those which the Supreme Court found "ordinary and necessary" beyond question in *Commissioner v. Heininger,* supra. The Court there said: "There can be no doubt that the legal expenses of respondent were directly connected with 'carrying on' his business." (p. 470)

The two most relevant decisions of the Supreme Court are not the two decisions cited by Appellee but, on the contrary, are: *Commissioner v. Heininger,* supra, expressly affirmed in *Lilly v. Commissioner,* supra, holding that expenditures of the character here

involved are "ordinary and necessary" beyond question, and *Bingham's Trust v. Commissioner,* supra, holding that a regulation to the extent it bars as a deduction expenditures which are "ordinary and necessary", is invalid.

Appellee has not replied to those decisions.

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**(5) REPLY TO CONTENTION: "CONTRARY TO THE CONTENTION RAISED BY TAXPAYERS (Br. 42-58, 66-67, 74-75), THE REGULATION IS NOT LIMITED TO THOSE EXPENDITURES WHICH ARE IMPROPER, CORRUPT, OR AGAINST 'PUBLIC POLICY', NOR ONLY TO THOSE WHERE DIRECT PRESSURE IS BROUGHT UPON A LEGISLATURE." (Appellee's Br. 18.)**

Appellee has misunderstood taxpayers' contentions. In the very first contention set forth in taxpayers' brief, taxpayers maintained—aside from any question of public policy—that application of the Regulation was clearly in excess of the rule-making authority of the Commissioner "within the limits of a reasonable interpretation" of the will of Congress expressed in the Code (Appellants' Br. 23).

It is not incumbent upon taxpayers in this case, nor is it a material issue, to delineate the detailed outer boundaries of the area within which the Regulation may be validly applied by the Commissioner in the exercise of such rule-making authority. It is sufficient alone to show that the application of the Regulation by the Commissioner is clearly out of bounds. Thus the issue here is not the broad general issue which the Appellee seeks to make: whether the Regulation in the abstract is valid or whether the

Regulation as applied to other and different facts is valid.

That the Regulation—aside from public policy—may be validly applied to some expenditures referred to in the Regulation and within the rule-making power of the Commissioner in interpreting "ordinary and necessary" we need not dispute. Thus it may be reasonably contended that the Regulation may be validly applied to expenditures referred to in the Regulation which only remotely or indirectly affect taxpayer's business, such as those set forth in the decisions referred to in the third classification of cases set forth under topic (1) of this brief.

Taxpayers, lastly, in their brief maintained that the Regulation cannot be validly applied to the instant expenditures on the ground of public policy (Appellants' Br. 42-58). This contention is entirely separate and apart from the first contention that the Regulation cannot be validly applied in the exercise of the rule-making authority of the Commissioner in reasonably interpreting what is "ordinary and necessary".

The two contentions involve entirely different considerations. Thus in considering whether the Regulation can be validly applied on the ground of public policy, it is not necessary to consider whether the particular expenditures factually are "ordinary and necessary" beyond question. Once the expenditures are determined to be against public policy they are outlawed and non-deductible without any further consideration of the question whether they are "ordinary and necessary" within the clear and accepted meaning of

those words. The expenditures so outlawed may simply be regarded as non-deductible irrespective of their character or alternatively it may be held that expenditures which violate public policy clearly cannot be regarded as being "ordinary and necessary". Thus in the *Textile* case the expenditures were outlawed on the ground of public policy and no further consideration was required.

Appellee clearly admits, however, that the Regulation cannot be validly applied to the instant expenditures on the ground of public policy. Appellee states: ". . . it is immaterial whether . . . the promotion or defeat of legislation . . . is against 'public policy' for the regulation applies to all attempts to influence the promotion or defeat of legislation". (Appellee's Br. 6; see also pp. 18-23.)

With the elimination of the "public policy" issue from this case, the remaining issue is confined to the question whether: the Regulation as here applied is in excess of the administrative rule-making authority of the Commissioner in reasonably interpreting the will of Congress expressed in the factual words "ordinary and necessary" contained in Section 23(a).

Even though the basis of the decision in the *Textile* case was clearly stated to be public policy, Appellee, nonetheless, contends that said decision is controlling here. Appellee contends that the items disallowed in the *Textile* case were not for "lobbying" and that the existence of the contingent fee contracts was not a factor in the decision (Appellee's Br. 19). But it is clear that the services rendered and expenditures in-

curred in connection therewith had only one single objective: to reach Congress with respect to pending legislation. Thus the Court clearly said "Petitioner's employment was made with a view towards procuring legislation . . ." (p. 336). The court expressly characterized the expenditures as expenditures for "lobbying" (p. 337) and the contracts as "Contracts to spread such insidious influences through legislative halls have long been condemned" (p. 338). The concluding statement by the Court clearly shows that the decision was based on public policy: "There is no reason why, in the absence of clear Congressional action to the contrary, the rule-making authority cannot employ that *general policy* in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction" (p. 339) (italics ours). "The *general policy* being clear it is not for us to say that the line was too strictly drawn". (p. 339) (italics ours.)

Appellee contends taxpayers construe too "narrowly" the decision in the *Textile* case (Appellee's Br. 21). But it is not taxpayers' construction of the decision—it is the construction of the Supreme Court itself in two subsequent cases wherein the Court clearly said, with respect to the *Textile* case: "Similarly, one who has incurred expenses for *certain types of lobbying* and political pressure activities with a view to influencing federal legislation has been denied a deduction", *Commissioner v. Heininger,* supra, (p. 473) (italics ours); "In Textile Mills Securities Corp. v. Commissioner, 314 US 326, 86 L ed 249, 62 S Ct

272, this Court accepted an interpretation of that section by a Treasury Regulation which disallowed the deduction of *certain expenditures for lobbying purposes*. In doing so, the Court referred to the fact that some types of lobbying expenditures had long been condemned by it . . .", *Lilly v. Commissioner,* supra (p. 95) (italics ours).

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**(6) REPLY TO CONCLUDING CONTENTION AND BASIC ERROR OF APPELLEE IN ASSERTING THAT SMITH v. COMMISSIONER AND COMMISSIONER'S ACQUIESCENCE THEREIN HAS "LOST ITS BASIS WITH THE TEXTILE MILLS DECISION". (Appellee's Br. 22.)**

In the closing paragraph of its brief Appellee states: "Smith v. Commissioner, 3 T.C. 696 (Acquiescence 1944 Cum. Bull. 26), *decided prior to Textile Mills,* held deductible contributions by a lawyer . . ." (Appellee's Br. 22) (italics ours).

*Appellee is in error.* The decision in the *Smith* case and the Commissioner's asquiescence therein (both in 1944) took place three years *after* the decision in the *Textile* case (1941).

Appellee, resting on this basic error, asserts that the decision in *Smith v. Commissioner* and the Commissioner's acquiescence therein "lost its basis with the *Textile Mills* decision . . ." (Appellee's Br. 22).

On the contrary, the decision in the *Smith* case and Commissioner's acquiescence therein, being subsequent to the *Textile* case, are in conformity with the *Textile*

case and are an express recognition of the limitations of that decision.[3]

It is also significant that the decision in the *Smith* case and Commissioner's acquiescence therein were subsequent to the decision in the *Scavenger* case (1936).

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## CONCLUSION.

The Commissioner by his holding in this case has placed Appellant taxpayers and other taxpayers similarly situated in an impossible position.

Prior to incurring the expenditures, the Commissioner by his acquiescence in the *Smith* case publicly declared that expenditures incurred in connection with measures voted upon by the People, where factually they are "ordinary and necessary"—are deductible.

But once the expenditures were incurred, the Commissioner seeks to repudiate his prior public declaration and now contends that the expenditures, even though in fact "ordinary and necessary", all the while were categorically barred by a regulation and therefore—are not deductible.

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[3]It is to be noted that in 1950 the Tax Court reaffirmed the *Smith* case in *Roberts Dairy Co. v. Commissioner,* 9 T.C.M. 1000 (involving expenditures incurred in connection with legislation by Congress), wherein the Court stated: "Petitioner has cited several cases as authority for allowing this deduction as a business expense which we think inapplicable. In *Luther Ely Smith,* 3 T. C. 696 [Dec. 13,891], the Court held that no legislation was involved inasmuch as an amendment to the Constitution of the State of Missouri was voted by the people and became self-operative without approval of the legislature." [p. 1003]

However, aside from the inequity of the Commis-sioner's ruling, taxpayers here are supported by th law because the Supreme Court has clearly held: (1) Expenditures of the character here incurred in pre-serving the continued existence of a business are "or-dinary and necessary" beyond question and hence deductible within the will of Congress expressed in Section 23(a), *Commissioner v. Heininger,* supra *Lilly v. Commissioner,* supra; (2) The Regulation to the extent it bars such expenditures as a deduction is in contravention of Section 23(a) and therefore is invalid and in excess of the rule-making authority of the Commissioner in administering Section 23(a) *Bingham's Trust v. Commissioner,* supra.

Wherefore Appellants respectfully contend that th judgment of the District Court was in error and that accordingly, the judgment be reversed.

Dated, San Francisco, California,
May, 1957.

Respectfully submitted,
Athearn, Chandler & Hoffman,
Walter Hoffman,
Clark W. Maser,
Jones & Grey,
A. R. Kehoe,
Hargrave A. Garrison,
*Attorneys for Appellants.*